

STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE

In the Matter of: Proposed adoption or amendment of the Insurance Commissioner's regulations pertaining to Pure Premium Rates for workers' compensation insurance, California Workers' Compensation Uniform Statistical Reporting Plan—1995, Miscellaneous Regulations for the Recording and Reporting of Data, and the California Workers' Compensation Experience Rating Plan—1995. These regulations will be effective on January 1, 2008.

FILE NUMBER REG-2007-00053

DECISION AND ORDER

1. Decision on Pure Premium Rates

California's workers' compensation insurers are enjoying historic cost reductions that have translated into extraordinary profits. It is clear that the reforms to the workers' compensation system are working and insurers are benefiting from a healthy, robust and competitive market. However, this profitability, in my opinion, has not been shared with employers. While there exist a number of uncertainties in the record that warrant further monitoring before an adjustment to the Pure Premium Rates needs to be made, I do believe that the premiums being charged to employers are still too high. Since the reforms of 2003, the cost of claims for insurers has dropped 70 percent; however, insurers' rates have lagged behind since they have only been reduced by 55 percent. In this extremely profitable market, there is excess capacity for insurers' to reduce their rates even further.

My powers as Insurance Commissioner with regard to workers' compensation insurance rates are limited to issuing only an advisory decision on workers' compensation insurance pure premium rates and examining the rates filed by insurers for inadequacy and unfair discrimination. California insurance law requires the WCIRB to analyze past cost trends and advise me on the pure premium rates necessary to pay the anticipated claims in the next year or within the next six months for an interim rate. I am required to conduct a hearing on the proposed rate change and then render a decision on the proposal. This decision then becomes an advisory rate increase or decrease for the workers' compensation insurance industry. However, I have no power to require insurers to increase or decrease their rates, and the insurance companies are free to set their rates at any level so long as those rates are not so low as to adversely affect their financial stability or unfairly discriminatory.

I have determined that there shall be no change to the Pure Premium Rates at this time. Based upon my review of the Proposed Decision in this matter, including the extensive analysis performed by the Department's Senior Actuaries of the Workers' Compensation Insurance Rating Bureau's (WCIRB) filing, I have determined that there exist a number of issues in the record that remain uncertain and warrant further monitoring before an adjustment to the Pure Premium Rates needs to be made.

The current record demonstrates that the costs of indemnity and medical have leveled off, there continue to be decreases in claim frequency, and the recent reforms to the workers' compensation system are continuing to work. The change to temporary disability benefits resulting from the passage of AB 338 may have a minor effect on workers' compensation costs, but the evidence is based upon data from the pre-reform system that did not have the current limitations on medical treatment and incentives for return to work. Therefore this portion of the proposed increase needs to be further evaluated or more data is needed to support this increase.

The major portion of the WCIRB's proposed adjustment to the Pure Premium Rates comes from higher loss adjustment expenses generated by the industry. The evidence and analysis show that this is in large part due to the costs of insurers dealing with the changes resulting from the reforms and also having to deal with retroactive effect on existing claims. A significant portion is one-time costs and should not be part of an adjustment to the Pure Premium Rates. Additionally, one has to look closely at the cost efficiency of the industry as it is adapting to the changes. Such increases in loss adjustment expenses were observed in prior changes to the workers' compensation system, but nothing close to the magnitude of the current reforms occurred previously. Even though my actuaries believe there may be some increased loss adjustment costs in the new system, further monitoring and study of the loss adjustment expenses, which the WCIRB has already undertaken, will determine if this change is temporary or whether a portion of the loss adjustment expense increase will remain.

It is clear from the actuaries' review that the industry continues to make a very healthy return on the premiums it charges for workers' compensation insurance and its investment income from those premiums. California insurers' record-low loss ratios, which are the claims costs being paid by insurers versus the premiums employers are charged, far lower than what insurers are experiencing in the rest of the country. A change in the Pure Premium Rates, without further current data, is not warranted in light of the substantial profitability the workers' compensation insurance industry is experiencing in California.

I expect that insurers will continue to decrease their premiums and there will continue to be competition for California employers' workers' compensation business since there clearly continues to be a lag between the Pure Premium Rate adjustments that the Insurance Commissioner recommends and what employers are charged. There is still time to assess whether increased costs will occur over time and make appropriate adjustments when warranted.

2. Continuing Issues with Analysis and Forecasting by the WCIRB

As noted in this and previous Proposed Decisions, the WCIRB has much work to do in acquiring and analyzing data to develop better forecasting. The recommendations of the Department's actuaries to have the WCIRB develop more current claims data, similar to what insurers provide to the CWCI, is needed for better accuracy in determining the Pure Premium Rates, for use in redeveloping the experience rating system, and to make sure that insurers are providing accurate and timely data as required by the California Insurance Code.

The Department will be working with the WCIRB in determining how best to revise the data requirements needed to create a more dynamic and robust database. In the meantime, the Department is continuing with its review of the WCIRB to confirm that it is carrying out its functions efficiently and timely as the state's only Rating Organization.

3. Improvements by the WCIRB

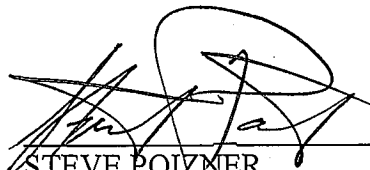
I am encouraged to see that the WCIRB has established the Claims and Legal Subcommittee to review changes and trends that develop with insurer claims handling. Over time this should contribute to a multifaceted approach in evaluating changes to the workers' compensation system. I am also encouraged by the fact that the WCIRB has decided to retain outside actuarial expertise to evaluate its forecasting methods.

The WCIRB did attempt to provide more variety in its methods to determine the Pure Premium Rates. However, as noted by the Department's actuaries, the WCIRB can still make improvements by exploring and pursuing different methods of acquiring and evaluating data. Therefore, I am directing the WCIRB work with the Department and pursue the recommendations made by my Senior Actuaries regarding these efforts. I look forward to those results along with what I have requested of the WCIRB in my previous Decision and Order.

ORDER

I hereby adopt the attached Proposed Decision and Proposed Order of Hearing Officer Christopher A. Citko as my Decision in the above entitled matter, in addition to those items ordered or directed above, with the exception to the change in the Pure Premium Rates. It is ordered that the Pure Premium Rates remain unchanged, and it is further ordered that the Expected Loss Rates be modified to reflect that there has been no off-balance adjustment.

IT IS SO ORDERED THIS 28th DAY OF NOVEMBER, 2007.



STEVE POIZNER
Insurance Commissioner